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Fight over uncollected sales tax heats up

By TIFFANY RAY

More than \$1.1 billion in taxes linked to purchases from out-of-state retailers went uncollected in California last year, and the losses are expected to mount as consumers continue buying more goods online.

Companies operating in California are required to collect sales taxes from consumers on the goods they sell. Out-of-state retailers such as Amazon.com and Overstock.com, which sell to consumers in California but do not have a physical presence here, are not.

By law, California consumers are required to pay these so-called use taxes on out-of-state purchases themselves, but the vast majority do not. A recent report by the State Board of Equalization found that, on average, Californians pay only 1.4 percent of the use taxes they owe.

The issue is not unique to California. Around the country, state and local governments are losing out on tax dollars from out-of-state purchases because federal law currently prohibits state governments from requiring companies to collect taxes if they have no physical presence in the state.

Bill Dombrowski, president and CEO of the California Retailers Association, said the exemption the law creates for online retailers gives them a 10 percent price advantage over competitors. "It's killing brick-and-mortar retailers," he said, "and it's killing local governments."

David Stewart, dean of the business school at UC Riverside, said the rise in e-commerce has left substantial tax dollars at stake, so the issue is "suddenly getting people's attention."

Although consumers are obligated to pay the tax, there is no real enforcement mechanism in place and, therefore, little incentive for them to do so. Large, conspicuous purchases might be simple to track, but most online sales are modest, Stewart said. "It's a book, it's a fragrance product, it's a small appliance. Those are things that are really hard to detect."

Jerome Horton, chairman of the Board of Equalization, said consumers are largely unaware they owe tax on those purchases because out-of-state companies are "intentionally misleading the consumer to believe the tax is not

due," which benefits the company. "They encourage it," he said. "They use it as a marketing tool."

Horton said the board's recent report showed that California should require online retailers to collect the taxes owed.

Jonathan Johnson, president of Utah-based Overstock.com, which does not collect taxes on purchases by California consumers, said the argument that the exemption is unfair comes primarily from big-box retailers like Walmart, the same companies that in previous years were accused of running Main Street mom-and-pops out of business.

He said changing the rules would stifle small businesses at a time when they are most needed to help pull the country out of tough economic times.

COMPLIANCE ISSUE

Tax rates and regulations vary widely among cities, states and other taxing jurisdictions, Johnson said. Complying with all of them would be difficult and expensive for a company the size of Overstock.com, which has 1,600 employees and more than \$1.1 billion in annual sales, he said. For a smaller company, it would be "difficult, expensive and impossible."

But Dombrowski said brick-and-mortar retailers such as Target and Barnes and Noble, already collect taxes on online sales, "so we know it's not technologically complex."

In January, Assemblywoman Nancy Skinner, D-Berkeley, introduced legislation that would compel online retailers to collect taxes by expanding the definition of an in-state presence to include companies that hire California affiliates such as bloggers or coupon aggregators, which are typically paid a commission in exchange for driving traffic to retailers' sites.

The bill is estimated to generate up to \$317 million in use taxes, if retailers comply.

But online retailers have responded to similar legislation enacted in New York and some other states by simply firing their affiliates in those states. An analysis of the bill by Board of Equalization staff warned that Amazon.com, which has about 10,000 affiliates in California, already has said it would sever ties with those businesses if the legislation is adopted.

And Johnson said Overstock.com would sever ties with its 200 affiliates here. The company has jettisoned affiliates in five other states already, he said, and sales have not suffered.

AFFILIATES AT RISK

In all, there are an estimated 25,000 such affiliates operating in California, according to the state.

Michelle Steel, vice chair of the Board of Equalization, said the California bill would be "bad policy."

"We know from the experience of other states who have passed such laws, that if we follow suit we will lose jobs, we likely won't collect any revenue, and we will be mired in lawsuits," she said in a statement.

Horton said the bill is not likely to encourage collection of the tax among online retailers, but it could help redirect sales to tax-collecting retailers, and that could mean more jobs and revenue for California.

Johnson said Overstock.com would collect taxes on sales when Congress or the U.S. Supreme Court says they have to. "Until then, we will not."

Dombrowski said the association supports state legislative efforts, but "the best solution would be for Washington, D.C., to address the issue."

Either way, sales trends are unsustainable, he said.

"There has to be something done about this, or retail will consist of showrooms, and people will just go out and shop on the Internet."